



Janet Napolitano, Governor

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ARIZONA DEPARTMENT OF REVENUE

MISSION STATEMENT

To administer tax laws fairly
and efficiently for the
people of Arizona

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be viewed on our Internet
website:

www.azdor.gov

2005 ARIZONA LEGISLATIVE SUMMARIES

The 2005 Legislative Summary is a brief summary of the tax-related bills that were enacted by the Arizona Legislature and approved by the Governor. This month: Income Tax.

The general effective date is **August 12, 2005** unless otherwise stated. Copies of these bills can be downloaded at www.azleg.state.az.us/FinalDisposition.asp or may be requested from the Secretary of State's Office by calling (602) 542-4086.

House Bill 2059 (Chapter 148)

Income Tax Credits

HB 2059 amends the Individual and Corporate income tax credits for pollution control equipment to provide clarification of property qualifying for the credit.

House Bill 2139 (Chapter 289)

Income Tax; Corporate Sales Factor

Optional Sales Factor Provisions

- Provides an optional apportionment formula for corporate income tax for multi-state and multi-national corporations if certain conditions are met.
- If the conditions are met, allows multi-state and multi-national corporations to elect an apportionment formula using the current double-weighted sales factor or an 80% sales factor apportionment for corporate income tax purposes.
- Provides a three-year phase-in for the option of the 80% sales factor apportionment formula, beginning with tax year 2007 with a 60% sales factor apportionment formula. In the second year, the sales factor weight is increased to 70% and for 2009 and subsequent years, the sales factor is increased to 80%.

Conditions for Optional Sales Factor Provisions

- Provides that the optional enhanced sales factor apportionment formula is effective beginning in tax year 2008

but that it is retroactive to tax year 2007 if the following conditions are met:

- One or more corporations announce on or after June 1, 2005 that one or more capital investment projects, individually or collectively, exceed \$1 Billion and that these corporations report their activity to the Joint Legislative Budget Committee (JLBC) and the Governor's Office of Strategic Planning and Budgeting (OSPB). Each report must include:
 - The date the project will begin and an estimated completion date of the project;
 - A description of the construction or reconstruction, expansion, installation of new equipment, tooling or retooling;
 - Estimated cost of the project and the number of contractors expected to be employed, and
 - Estimated construction employment and the estimated long-term employment of the completed project.
- By December 15, 2007, the corporations that reported their proposed capital investments to JLBC

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*****REMINDER*****

FOR NON-EFT TPT FILERS

**To avoid a delinquency, postmark your
July 2005 TPT return no later than
August 25, 2005 or deliver to DOR no later
than August 30, 2005.**

The Tax Facts—Summary of General Fund
Revenues & Individual Income Tax Receipts—
are available on the department's website,
www.azdor.gov

E-Mail Your Questions

If you have a question that you cannot find the
answer to, our Technical Assistance personnel may
prove useful to you. We will gladly respond to any
e-mail technical tax inquiry. All inquiries will be
responded to within two working days.

E-mail your question to:

TaxpayerAssistance@azdor.gov

In the interest of maintaining confidentiality, DOR
cannot respond to inquiries that include a Social
Security number, FEIN, TPT or W/H number, or
other specific taxpayer identifiers.

Department of Revenue Telephone Numbers & Web addresses

Individual & Corporate Income Tax

..... (602) 255-3381

Toll-free from

area codes 520 and 928..... (800) 352-4090

Transaction Privilege, Use, Withholding Tax, Licensing..... (602) 255-2060

Toll-free from

area codes 520 and 928..... (800) 843-7196

Hearing Impaired TDD User .. (602) 542-4021

Toll-free from

area codes 520 and 928..... (800) 397-0256

To order forms by phone (602) 542-4260

Forms by fax (602) 542-3756

**Forms and instructions are also available
on our website at**www.azdor.gov

**Businesses can now register, file and pay
online at**www.AZTaxes.gov

TAX CALENDAR

AUGUST 2005

Due Date		For Period Ending
1	Form A1-QRT—Withholding Tax	6/30/05
15	Income Tax Returns:	4/30/05
	Form 120: Corporation	
	Form 140: Individual	
	Form 141: Fiduciary	
	Form 165: Partnership	
15	Form 120: Corporation with Automatic Extension	10/31/04
15	Form 120S: S Corporation	5/31/05
15	Form 99: Exempt Organization Annual Information Return	
	Form 99T: Exempt Organization	3/31/05
15	Form 120ES: Estimated Tax Payment, Corporation	
	First Installment	4/30/06
	Second Installment	2/28/06
	Third Installment	11/30/05
	Fourth Installment	8/31/05
22	Form TPT-1: Transaction Privilege Tax: July Monthly Filers and Quarterly Filers	7/31/05
22	Bingo: Financial Reports	7/31/05
22	Luxury Tax: Various Forms	7/31/05
25	EFT Form TPT-1 and Payment: Transaction Privilege Tax: July Monthly Filers	7/31/05

Withholding Tax Payment Information:

If the average amount of Arizona income taxes withheld in the
preceding four calendar quarters **exceeds** \$1,500 the employer must
make its Arizona withholding payments to the Department of
Revenue at the same time as the employer is required to make
federal withholding deposits.

If the average amount of Arizona income taxes withheld in the
preceding four calendar quarters **does not exceed** \$1,500 the
employer must make its Arizona withholding payments to the
department on a quarterly basis.

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of Revenue. Information contained herein is of a general nature
and is not designed to address complex issues in detail.
Taxpayers requiring information concerning a specific tax matter
should contact the appropriate office. This newsletter is available
in an alternative format upon request. Subscription information
may be obtained from the Publications Unit at 602-716-6797 or
toll free from area codes 520 & 928, 1-877-863-0655.

CHANGE IN TOWN TAX CODE—TOWN OF QUEEN CREEK EFFECTIVE SEPTEMBER 1, 2005

Effective September 1, 2005: On June 1, 2005 the Mayor and Town Council of the Town of Queen Creek passed ordinance number 316-05. Ordinance 316-05 increases the Queen Creek Town Privilege Tax on Construction Contracting Section 415, 416 and 417 from **2% to 4%**. The tax on Construction Contracting shall be reported using **QC005**.

The increase imposed by ordinance 316-05 shall not apply to construction contracts entered into prior to the effective date of the ordinance. Pre-existing construction contracts should be reported using **QC008** at a rate of **2%**.

CHANGE IN CITY TAX CODE—CITY OF ELOY EFFECTIVE OCTOBER 1, 2005

Effective October 1, 2005: On July 25, 2005 the Mayor and City Council of the City of Eloy passed ordinance number 05-593. Ordinance 05-593 increases the Eloy City Privilege Tax on Construction Contracting Section 415, 416 and 417 from **3% to 4.5%**. The tax on Construction Contracting shall be reported using **EL005**.

The increase imposed by ordinance 05-593 shall not apply to construction contracts entered into prior to the effective date of the ordinance. Pre-existing construction contracts should be reported using **EL008** at a rate of **3%**.

CHANGE IN CITY TAX CODE—CITY OF COOLIDGE EFFECTIVE OCTOBER 1, 2005

Effective October 1, 2005: On July 25, 2005 the Mayor and City Council of the City of Coolidge passed ordinance number 05-09. Ordinance 05-09 increases the Coolidge City Privilege Tax on Construction Contracting Section 415, 416 and 417 from **3% to 4%**. The tax on Construction Contracting shall be reported using **CL005**.

The increase imposed by ordinance 05-09 shall not apply to construction contracts entered into prior to the effective date of the ordinance. Pre-existing construction contracts should be reported using **CL008** at a rate of **3%**.

CHANGE IN TOWN TAX CODE—TOWN OF ORO VALLEY EFFECTIVE FEBRUARY 1, 2006

Effective February 1, 2006: On June 15, 2005 the Mayor and Town Council of the Town of Oro Valley passed ordinance number 05-18. Ordinance 05-18 increases the **Additional Tax on Transient Lodging from 3% to 6%**. The Additional Tax on Transient

Lodging shall be reported using **Code OR003**. The total town rate for transient lodging is **8%, 2%** which is reported using code **OR000** and **6%** which is reported using code **OR003**.

2005 Legislation

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and OSPB must notify these offices that these projects have commenced and are in excess of \$1 Billion.

- JLBC and OSPB will jointly:
 - Publish a list of the corporations and projects reported to them for 2006, 2007 and 2008, and
 - By December 31, 2007, notify DOR and Legislative Council if the conditions for the enhanced sales factor formula have occurred.
- Requires each corporation that made capital investment commitments to file a report on the status of each project by December 31, 2005, 2006, 2007 and 2008.

House Bill 2155 (Chapter 11)

2005 Tax Corrections Act

HB 2155 makes technical, conforming and clarifying changes to Arizona tax statutes.

- Makes a correction to the enterprise zone credit. Corrects a bill from 2004 which was intended to allow taxpayers that filed their 1st or 2nd year credits for periods prior to 2002 on amended returns to be able to claim a 2nd or 3rd year credit in 2002 or later despite a previous change that provided that 2nd and 3rd year credits would only be allowed if the 1st or 2nd year was claimed on an original return. However, the change in 2004 only made the change retroactive to years beginning from and after December 31, 2003 which rendered the change meaningless since it would have been too late to claim the 2nd or 3rd year credits. This new provision makes the 2004 change retroactive to years beginning after December 31, 2001.

House Bill 2156 (Chapter 12)

Income Tax Credit Review Schedule

HB 2156 is the annual bill to update the income tax credit review schedule based on the recommendations of the Joint Legislative Income Tax Credit Review Committee. Removes the income tax credits that were reviewed in 2004 and adds these credits to the review schedule in 2009.

House Bill 2323 (Chapter 292)

Tax Credits; Water Conservation Systems

Provisions:

- Provides an individual credit for installation of a water conservation system in a residence to reclaim graywater. The credit is
 - 25 percent of the cost of installing a water conservation system not to exceed \$1000 in the taxpayer's Arizona residence.
 - total credit is limited to \$250,000 per year
- Provides a corporate credit for installation of plumbing stub outs for a separate graywater system

in a residence. The credit is

- for the full cost of installing a water conservation system plumbing stub out not to exceed \$200.
- total credit is limited to \$500,000 per year
- Requires the Department of Revenue (DOR) to establish a preapproval process for the tax credit applications.
- Allows the credit to be carried forward for five years.

Both credits are effective for taxable years beginning from and after December 31, 2006 and ending before January 1, 2012.

Senate Bill 1027 (Chapter 303)

Income Tax; Military Exemption

SB 1027 provides that in addition to the subtraction allowed under A.R.S. §§ 43-1022 and 43-1332, an individual or an estate may subtract compensation received for active service as a member of the armed forces of the United States to the extent not already excluded from Arizona gross income under the internal revenue code or subtracted from Arizona gross income pursuant to A.R.S. § 43-1022.

This bill will exempt active duty military pay from Arizona income tax. In the case where a taxpayer's only source of income is active duty military pay, the taxpayer will also be exempt from filing an Arizona income tax return under A.R.S. § 43-301 unless the taxpayer must file to claim a refund of Arizona income tax withheld. This provision is effective and applies to taxable years beginning from and after December 31, 2005 through December 31, 2006. Therefore, this legislation will apply to only the 2006 taxable year.

Senate Bill 1224 (Chapter 264)

Income Tax Credit; National Guard Employees

The bill adds new A.R.S. §§ 43-1079.01 and 43-1167.01 to provide an income tax credit for a taxpayer whose employee is a member of the Arizona National Guard, if the employee is placed on active duty. The amount of the credit is \$1,000 for each employee who is placed on active duty by the Arizona National Guard. To qualify for the credit, the employee must be a member of the Arizona National Guard who is employed by the taxpayer in a full-time equivalent position when the employee is placed on active duty. Each member of the Arizona National Guard who is employed must have served during the taxable year on active duty for training that exceeds the required annual training period, including any activation for federal or state contingencies or emergencies. Any amount of unused credit may be carried forward for not more than five consecutive taxable years' income tax liability.

The credit may be claimed only once by the taxpayer in

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any taxable year with respect to each employee who is placed on active duty by the Arizona National Guard. The taxpayer may also claim the credit again for that employee in a subsequent taxable year if that employee remains on active duty or is placed again on active duty in a subsequent taxable year.

Co-owners, including partners in a partnership and shareholders of an S corporation, may claim only the pro rata share of their allowable credit based on their ownership interest. The total of the credits allowed all co-owners may not exceed the allowable credit.

The credits will become effective beginning with the 2006 taxable year.

Senate Bill 1335 (Chapter 316)

Income Tax Credit; Small Business Investments

SB 1335 creates a new income tax credit for investments made after July 1, 2006, by individuals for qualifying investments in a qualified small business. Within 30 days after making the investment, investors apply to Commerce, which reviews the application to determine if the small business qualifies and if the investment itself qualifies. If both qualify, Commerce certifies the credit (including amount and years to be claimed) to the applicant and Revenue. Unless the small business in which the investment is made is a bioscience company or is located in a rural area of Arizona (county of 400,000 or less) the credit is ten percent of the investment amount for each of 3 consecutive years starting the year after the investment. The credit for small business in a rural or bioscience company is twelve percent for the first two years after the investment and eleven percent the third year. Unused credits may be carried forward up to three years. The investor must file a timely return to claim a credit or the credit for that year will expire.

To qualify an investment must be at least \$25,000 and the investor and affiliates cannot own more than thirty percent of the voting power of the small business. To be a qualified small business it must have a location within the state with two employees who are residents, must not have more than \$2 million in total assets and not have as a principal business an activity which is on the statutory disqualified list. In general, manufacturing, research and development, hardware and software services by providers of the same qualify. Other professional services, retail, agricultural, financial and health care do not. Activities involving human cloning or embryonic stem cell research do not qualify.

The credit is capped in four ways: (1) Commerce shall not authorize credits after June 30, 2011; (2) the total amount of credits to be authorized by Commerce in all years cannot exceed \$20 million; (3) each investor and its affiliates are limited to a total of \$250,000 in investments in any year; and (4) the total investments for all years in any given business cannot exceed \$2 million. Upon a

written request by a business, Commerce will certify that the business is a qualifying small business, a rural business and a bioscience business. This certification will remain effective for a year, unless Commerce revokes it. Investments made while a certification is in place will be considered qualified for credit purposes unless the investor knew or should have known the certification was in error.

Senate Bill 1283 (Chapter 278)

Forests Health Amendments

SB 1283 amends last year's Healthy Forest Legislation by adding a fuel tax reduction and beneficial property tax classification for qualifying property. The transaction privilege, use and income tax incentives for qualified businesses are kept with some changes. Businesses that qualify for the tax incentives are first certified by the state Department of Commerce (DOC), to be then approved or denied by the Department of Revenue (DOR). A qualifying business must be engaged in a qualifying project that promotes forest health as defined in the bill. The tax incentives may be forfeited or reclaimed if a business' certificate is revoked. DOR's primary involvement continues to be with the administration of the tax benefits, working with Commerce in designing the Memorandum of Understanding (MOU) required of qualified businesses and establishing the mechanism to terminate the certification of a qualified business and to recapture tax benefits as provided in the MOU. The bill also includes technical changes that were recommended by DOR last year but were not incorporated.

Senate 1347 (Chapter 317)

Tax Incentives; Movie Production

- Provides corporate and individual income tax and TPT/use tax benefits to motion picture production companies that pay at least \$250,000 in production costs in this state and meet other criteria. The companies must continue to meet all of these criteria during each 12-month period for which they are qualified for tax incentives.
- Provides that the income tax credit is effective for taxable years beginning from and after December 31, 2005 through December 31, 2010. Any costs that a qualified motion picture production company pays in this state that are directly attributable to the production of a motion picture in this state can be used to compute the credit.

Senate Bill 1466 (Chapter 115)

National Guard Relief; Tax Checkoff

This bill adds new A.R.S. § 26-183 to establish a national guard relief fund. This bill also adds new A.R.S. § 43-619 to establish a new refund check-off on the individual income tax return form. Under this bill, a

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IRS LAUNCHES STUDY OF S-CORPORATION REPORTING COMPLIANCE

WASHINGTON — Internal Revenue Service officials announced today the launch of a study to assess the reporting compliance of S corporations. The study, carried out under the National Research Program (NRP), will examine 5,000 randomly selected S corporation returns from tax years 2003 and 2004.

S corporations are entities whose income and deductions pass through the corporate structure to the shareholders. Since the mid-1980s, the number of S corporations has risen rapidly, growing from 724,749 in 1985 to 3,154,377 in 2002.

The growth rate has been even faster among S corporations with more than \$10 million in assets. From 1985 to 2002, the number of these larger S corporations grew more than ten-fold, from 2,305 to 26,096.

“The use of S corporations has exploded,” said IRS Commissioner Mark W. Everson. “The IRS needs a better understanding of what this means for tax compliance. This research is critical for achieving our strategic goal of ensuring that corporations and high-income individuals are paying their fair share.”

S corporations are now the most common corporate entity. In 2002, the latest year for which data is available, S corporation returns accounted for 59 percent of all corporate returns filed for that tax year. Two million S corporations reported net income of about \$248 billion and 1.2 million S corporations reported net losses of about \$63 billion.

Numerous restrictions and requirements apply to S corporations. For example, an S corporation can have no more than 75 shareholders and none of these can be another corporation or non-resident alien.

Program officials expect these audits to begin later this year. The last reporting compliance study of S corporations involved about 10,000 returns from tax year 1984, prior to the tax law changes that spurred the growth in S corporations. The new NRP initiative will

use a study approach designed to reach statistically valid conclusions regarding compliance behavior, while using a smaller sample of returns than in the past.

The results of the NRP study will be used to more accurately gauge the extent to which the income, deductions and credits from S corporations are properly reported on returns filed by the flow through corporations and their shareholders. When completed, this research will assist the IRS in selecting and auditing S corporation returns with greater compliance risk.

The research program on S corporations is a complement to the study of individual reporting compliance completed last year. The preliminary results from that study, announced in March, indicated that the gross tax gap is more than \$300 billion each year. IRS collection and compliance efforts reduce this gap by about \$50 billion each year.

The NRP, created in 2000, is a comprehensive effort by the IRS to measure payment, filing and reporting compliance for different types of taxes and various set of taxpayers.

Administering a tax system that serves America’s taxpayers by promoting fairness and operating efficiency and effectiveness is dependent on the agency’s ability to measure and distinguish between the many factors that impact compliance with tax laws.

“This research effort provides us the knowledge we need to both improve compliance and reduce unnecessary taxpayer burden,” said Everson.

Without reliable measures, the IRS faces major challenges in enhancing its ability to detect noncompliance, improve overall compliance and develop methods for allocating resources more effectively.

2005 Legislation

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taxpayer may designate an amount of the taxpayer's refund as a voluntary contribution to the national guard relief fund. The taxpayer may also donate any amount to the national guard relief fund in lieu of or in addition to the designated portion of the refund by an appropriate indication on the return and by including that amount with the return.

This bill is effective and applies to taxable years beginning from and after December 31, 2005.

Senate Bill 1529 (Chapter 334)

Budget; Revenue; Marriage; Taxation

This bill conforms the Arizona definition of "internal revenue code" to the Internal Revenue Code in effect on January 1, 2005 including those provisions that became effective during 2004 and adopts the retroactive effective dates of all retroactive provisions.

This bill will continue to exclude the three provisions where Arizona did not previously conform to the federal changes. For the 30 percent special bonus depreciation provided in the Job Creation and Worker Assistance Act of 2002, and both the 50 percent bonus depreciation and Section 179 expensing in the Jobs and Growth Tax Relief Reconciliation Act of 2003, Arizona taxpayers must make an adjustment to add back the amount taken at the federal level and subtract the amount allowable by Arizona when calculating Arizona income tax.

The bill amends A.R.S. § 43-1041 to provide for inflation indexing for the standard deduction. Under this bill, for each taxable year beginning on or after January 1, the department must adjust the standard deduction according to the average annual change in the metropolitan Phoenix consumer price index published by the United States

Bureau of Labor Statistics. The revised dollar amounts must be raised to the nearest dollar. The designated dollar amounts cannot be revised below the amount shown by the standard deduction in the prior taxable year. This provision is effective retroactively to taxable years beginning from and after December 31, 2004.

The bill amends A.R.S. § 43-1088 (credit for contributions to charities that provide assistance to the working poor) to increase the maximum credit allowed to married taxpayers to twice the amount allowed to single individuals or heads of household. This increase is phased in over a two year period. Under this amendment, the maximum credit for married taxpayers filing a joint return will be \$300 for 2005 and \$400 for 2006 and later years.

The bill amends A.R.S. § 43-1089 (credit for contributions to school tuition organizations) to increase the maximum credit allowed to married taxpayers to twice the amount allowed to single individuals or heads of household. This increase is phased in over a two year period. Under this amendment, the maximum credit for married taxpayers filing a joint return will be \$825 for 2005 and \$1,000 for 2006 and later years.

The bill amends A.R.S. § 43-1089.01 (credit for fees paid or contributions made to public schools) to increase the maximum credit allowed to married taxpayers to twice the amount allowed to single individuals or heads of household. This increase is phased in over a two year period. Under this amendment, the maximum credit for married taxpayers filing a joint return will be \$300 for 2005 and \$400 for 2006 and later years.

Provides taxpayers who made charitable cash contributions in January 2005 for tsunami relief can claim those contributions on their 2004 tax return instead of 2005.



Don't Forget...

You can still e-file Arizona Income Tax returns through October 17, 2005.
File electronically today.

Visit our website at www.azdor.gov for more information.



DOES YOUR COMPANY OWE 90% INTEREST AND A 25% CIVIL PENALTY?

The filing period for reporting Unclaimed Property to the department varies according to the type of business entity. In Arizona, a life insurance company that is a holder of property that is presumed abandoned shall file its report before May 1st and the report shall cover the prior calendar year. Any other holder shall file the report before November 1st and shall cover the last 12 months before July 1 of that year.

Holders who have never reported unclaimed property or who have filed an incorrect report may find some relief through Voluntary Disclosure Agreement (VDA)

with the Department of Revenue. The VDA, with certain stipulations, allows holders who have not previously filed or holders whose previous reports were incorrect to become current without any penalties or interest.

Holders can obtain a copy of the reporting instructions and forms for filing unclaimed property reports as well as information on the voluntary disclosure agreement by visiting the Department of Revenue web site at www.azdor.gov or by phone at 602-716-6029.